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The Kaufman Report

Trade what you see, not what you think.

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Tuesday March 3, 2009 **Closing prices of March 2, 2009**

Stocks gapped down at the open Monday and continued lower during another panic-selling 90% down day that saw the S&P 500 drop 4.66%. Every S&P sector was off at least 2.62%, led by Materials -6.88%, Financials -6.83%, Industrials -6.71%and Energy -6.41%. Stocks are in an extreme oversold condition, so we expect a bounce or even a tradable rally to commence at any time. However, we continue to think any rally will be of the bear market variety, and that conservative investors should be very defensive. This is a market for aggressive traders only, and conservative investors should not worry about missing the bottom when it comes. There may be another strong leg down yet to come, and avoiding devastating losses is more important for some investors than participating in the first bounce of a new bull market. **The lack of any type of oversold bounce causes us to reiterate our frequent warning from last October that a market that doesn't respond to oversold conditions is dangerous. The short-term, intermediate-term, and the long-term trends remain down. This continues to be an opportunistic trader's market, with adept traders able to take advantage long or short.**

"Study after study over the past several decades has shown how countries that spend more produce less, while nations that tax less produce more. Obama is doing it wrong on both counts". - Lawrence Kudlow

The S&P 1500 (158.75) was down 4.80% Monday. Average price per share was down 5.29%. Volume was 110% of its 10-day average and 125% of its 30-day average. 3.75% of the S&P 1500 stocks were up, with up volume at 1.24% and up points at 1.18%. Up Dollars was 1/100 of 1% of total dollars, and was 1/6 of 1% of its 10-day moving average. Down Dollars was 239% of its 10-day moving average. The index is down 4.80% in March, down 22.54% quarter-to-date and year-to-date, and down 55.45% from the peak of 356.38 on 10/11/07. Average price per share is $18.88, down 56.33% from the peak of $43.23 on 6/4/07.

Put/Call Ratio: 1.07. Kaufman Options Indicator: 1.00.

The spread between the reported earnings yield and 10-year bond yield is 27%, and 202% based on projected earnings.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $5.88, a drop of 69.34%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $14.01, a drop of 36.17%. The spread between reported and projected earnings is the widest the level in years. If investors believed the estimates stocks would be much higher.

484 of the S&P 500 have reported 4th quarter earnings. According to Bloomberg, 60.6% had positive surprises, 8.4% were line, and 31.0 % have been negative, a high number. The year-over-year change has been -59.7% on a share-weighted basis, -21.4% market cap-weighted and -29.3% non-weighted. Ex-financial stocks these numbers are -18.6%, -6.1%, and -12.1 %, respectively.

Federal Funds futures are pricing in a probability of 98.0% that the Fed will *leave rates unchanged*, and a probability of 2.0% of *raising 25 basis points to 0.50%* when they meet on March 18th. They are pricing in a probability of 90.3% that the Fed will *leave rates unchanged* on April 29th and a probability of 7.9% of *raising 25 basis points*.

IMPORTANT DISCLOSURES

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Economic News

3/2/09 – The ISM Manufacturing Index for February showed U.S. manufacturing contracted at a slower pace as it rose from 35.6 to 35.8 breaking a string of six straight declines. Personal Income in January was up 0.4% versus an estimated drop of 0.2%. Income was higher due to pay increases to government employees and cost of living adjustments to Federal transfer payments. Salaries and Wages fell 0.2%, the third consecutive decrease. Disposable income was up 1.5%. Personal Spending for January was up 0.6% versus the 0.4% estimate. This was the first time in seven months consumer spending increased.

2/27/09 – GDP for the fourth quarter shrank at a 6.2% annualized pace, the most since 1982 and worse than the estimate of -5.4%.

2/26/09 – Initial Jobless Claims for w/e 2/21 rose to 667,000, the highest since 1982. Durable Goods orders for January fell for a record 6th straight month, down 5.2% versus the estimate of -2.5%. Silver lining: inventories were down 0.8% from December. Singapore's economy shrank the most in 33 years last quarter, as GDP declined at an annualized 16.4% from the prior three months.

2/25/09 – Existing Home Sales for January fell 5.3% to 4.49 million annualized from 4.74 million in December. This was the lowest rate since 1997. Median price dropped 15% Y-o-Y. Distressed properties were 45% of sales.

2/24/09 – The Conference Board's reading of U.S. Consumer Confidence for February dropped to 25, the lowest ever and well below the estimate of 25. The S&P/Case-Shiller index of home prices in 20 U.S. cities plunged 18.5% in December Y-o-Y, the fastest drop on record. The MSCI World index is off to its worst ever yearly start. German business confidence was reported at a 26-year low. Eurozone Industrial Orders fell 5.2% in December versus November and -23.3% year-over-year.

2/23/09 – Dallas Fed Manufacturing Activity came in at -57.3% versus the estimate of -50.0%.

2/20/09 – The Consumer Price Index for January rose for the first time in six months by +0.3%, hitting the estimate. It was unchanged on an annual basis for the first time since 1955. Energy expense rose 1.7%, led by a 6% increase in gasoline prices.

2/19/09 – Initial Jobless Claims for the week ending 2/14 hit 627,000 versus the 620,000 estimate. The prior week was also 627,000. Continuing Claims were 4.99 million and set another record. The Producer Price Index for January was +0.8% versus a +0.3% estimate. Leading Indicators rose 0.4% versus the estimate of 0.1%. Some economists said this was a temporary jump.

2/18/09 – Housing Starts for January were the lowest on record at 466,000 annualized, missing the forecast of 529,000 and falling 17% from December. Building permits dropped 4.8% to 521,000 annualized.

2/17/2009 – Empire Manufacturing Index, which shows NY manufacturing, was -34.65 in February versus the -23.75 estimate. It dropped from -22.2 in January for the fastest drop ever. Net long-term TIC inflows, which shows international demand for U.S. financial assets, was $34.8 billion in December, up from -$21.7 billion in November and above the $20 billion estimate.

2/16/09 – Japanese GDP dropped 3.3% from the prior quarter, or 12.7% annualized, the biggest drop since 1974. Exports dropped at an 45% annualized rate as the synchronized global contraction hurts countries where global trade is extremely important.

2/12/09 – Jobless claims for w/e 2/7 were 623k versus 610k estimated. The 4-week moving average of 607,500 is the most since November 1982. Continuing claims w/e 1/30 were 4,810k versus estimated 4,800k, and rose the 4th week in a row to another record. Business Inventories for December -1.3% versus -0.09% estimate, biggest drop since 2001. Sales -3.2% after -5.7% in November. 1.4 months of inventory highest since April 2001. January Retail Sales +1% versus -0.8% estimate rose for the first time since July. Gasoline sales +2.6%, sales at auto dealers and parts stores up 1.6% for the first gain since August.

2/11/09 – China exports fell 17.5% year-over-year in January, the most in 13 years. Imports plunged by a record 43.1%. The $39.1 billion trade surplus was China's 2nd biggest ever. Numbers may be skewed by the Chinese New Year.

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Economic News

2/11/09 – The U.S. December trade deficit was $39.9 billion, wider than the $35.7 billion estimate. It was the lowest in almost six years. Exports and imports each declined for the 5th straight month, highlighting the effects of the synchronized global contraction. This is causing rumblings of protectionism worldwide, which would not be a good thing for the global economy.

2/10/09 – Wholesale inventories in December fell 1.4% versus a projected drop of 0.7%. Inventories have dropped four straight months, the longest streak in almost seven years. At current demand levels there is a 1.27 month supply of inventory, the highest since 2002. This points to further reductions in production. Factory inventories fell 1.4% in January. Retail inventories will be reported 2/12.

2/6/09 – The Unemployment Rate in January hit 7.6%, slightly above the 7.5% estimate. This was up from 7.2% in December and the highest since 1992. Payrolls fell by 598,000 (estimate 540,000), the biggest decline since December 1974. This is the first time since the beginning of payroll records in 1939 that job losses exceeded 500,000 for three consecutive months. Average Hourly Earnings increased 3.9% year-over-year.

2/5/09 – Initial Jobless Claims increased by 35,000 for the week ending 1/31 to 626,000, the highest number since October 1982. Continuing Claims hit a record 4.788 million for the week ending 1/24. Silver lining: Productivity rose 3.2% in the fourth quarter versus a 1.6% forecast. U.S. December Factory Orders dropped 3.9% versus a -3.1% estimate. Excluding transportation equipment (cars and aircraft) orders fell 4.4%.

2/4/09 – ADP Employer Services report showed a loss of 522,000 jobs in January, less than the 535,000 forecast and much lower than the December loss of 659,000. The Institute of Supply Management index of non-manufacturing businesses rose to 42.9 in January from 40.6 in December, and was above the estimate of 39.0.

2/3/09 – U.S Pending Home Sales rose for the first time in four months. The December increase of 6.3% beat the estimate of 0.0%. November showed a drop of 4%. According to the U.S. Census Bureau, a record 19 million U.S. houses were vacant at the end of 2008 for a 2.9% vacancy rate (vacant for sale), the highest ever. Purchases of New Homes in December, reported last week, dropped 14.7% versus November.

2/2/09 – Personal Income fell 0.2% in December, better than the -4% estimate, the third straight decline. The last three-month decline was January 1954. Personal spending in December fell 1% versus the .9% estimate, for a record sixth consecutive month. Consumer spending rose 3.6% for 2008, the smallest gain since 1961. Consumer Spending dropped at a 3.5% annual pace in Q4 versus 3.8% in Q3, the first ever declines above 3% in consecutive quarters. Silver lining: the decrease in spending pushed the savings rate up to 3.6% in December from 2.8% in November.

S&P 1500 Analysis - Wayne S. Kaufman, CMT

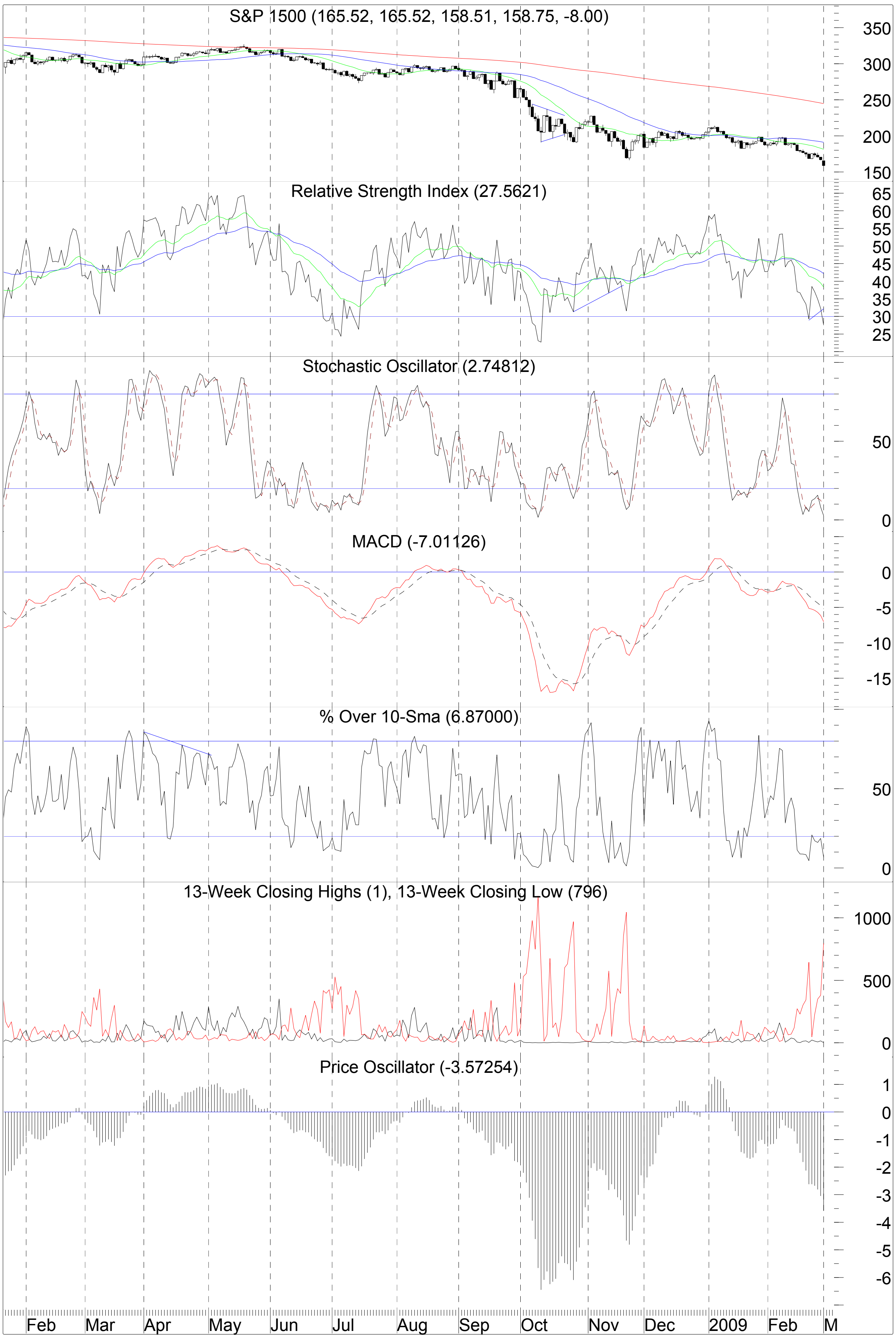
Monday's gap down creates resistance at the 730 - 735 zone.

There is a slight positive divergence on the RSI.

S&P 1500 Analysis - Wayne S. Kaufman, CMT

Since gapping down below the triangle the S&P 500 has crashed almost 16% in two weeks. It has gapped down twice in the last three sessions and is extremely oversold with some kind of bounce long overdue.

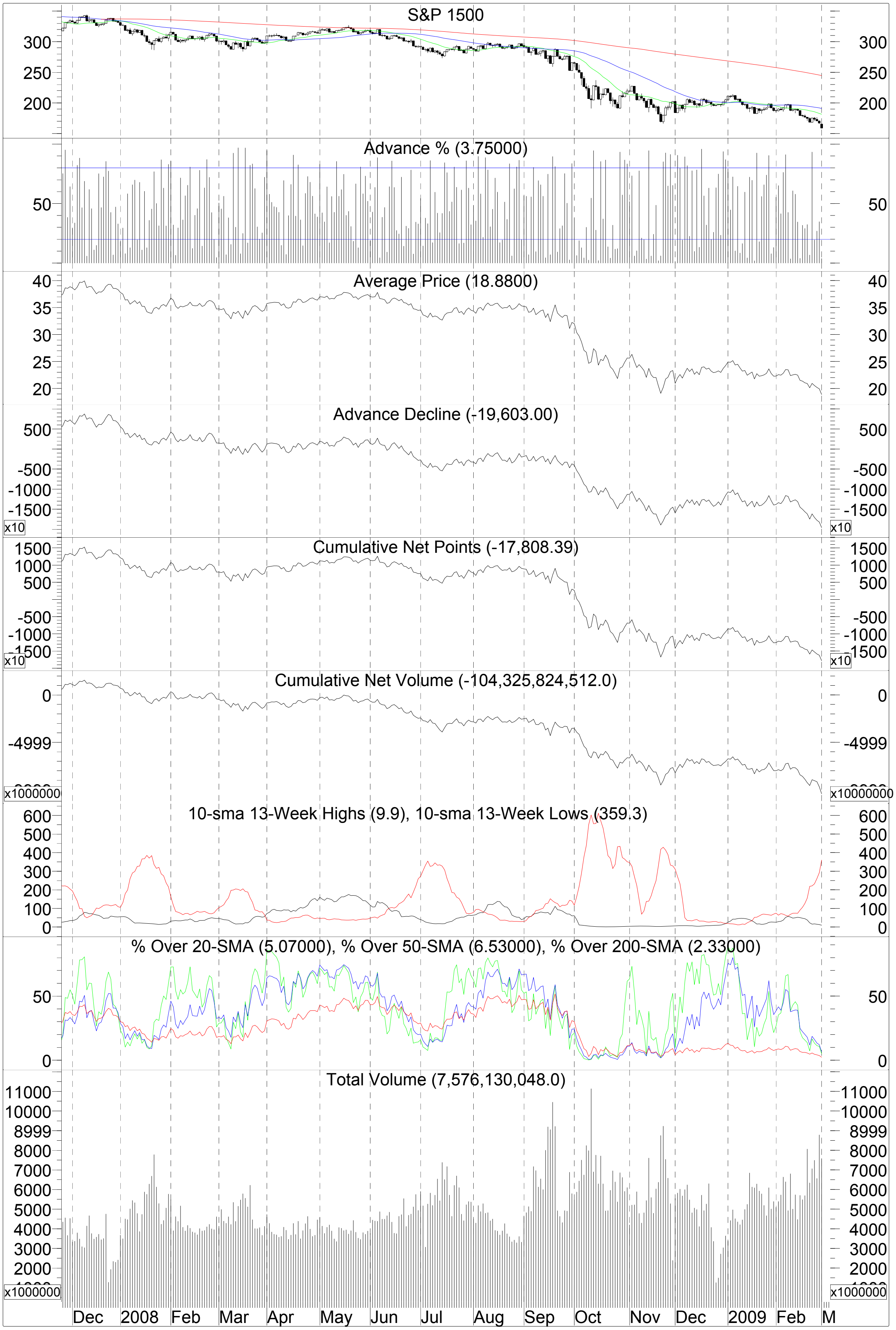
S&P 1500 Analysis - Wayne S. Kaufman, CMT



Our momentum indicators are all in the oversold zone.

Only 6.8% of stocks are over their 10-sma.

S&P 1500 Analysis - Wayne S. Kaufman, CMT

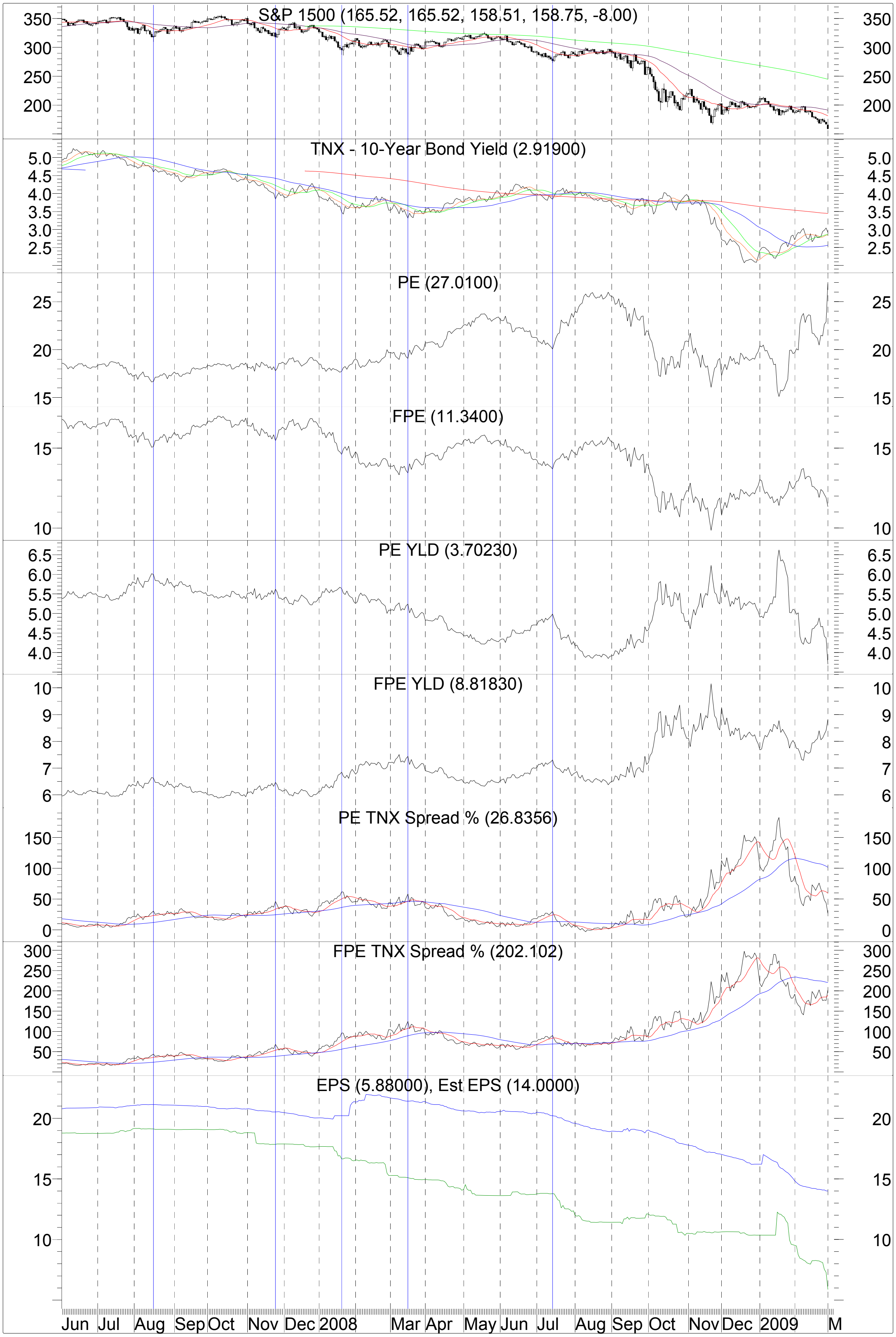


3.75% of stocks traded higher Monday.

All of our statistics of market breadth made new lows Monday, pointing to lower prices in the future.

These percentages are extreme, but the percent over 200-sma is the lowest yet.

S&P 1500 Analysis - Wayne S. Kaufman, CMT



The P/E ratio is shooting up even as the index drops, while earnings drop like a rock. This big move is mostly due to AIG.

The spread between earnings and the 10-year bond yield is at a dangerous level.

The spread based on forecast earnings remains at a level where stocks should be attractive. Are the analysts finally going to get it right?